

of the requirements of section 408(b)(1) of the Act. The loan agreement provides that at the end of two years M must pay the remaining balance in full or the parties may renew for an additional two year period. At the end of the initial two year period, the parties agree to renew the loan for an additional two years. At the time of renewal, however, A fails to adjust the interest rate charged on the loan in order to reflect current economic conditions. As a result, the interest rate on the renewal fails to provide a "reasonable rate of interest" as required by section 408(b)(1)(D) of the Act. Under such circumstances, the loan would not be exempt under section 408(b)(1) of the Act from the time of renewal.

Example 3: The documents governing plan P's participant loan program provide that loans must bear an interest rate no higher than the maximum interest rate permitted under State X's usury law. Pursuant to the loan program, P makes a participant loan to A, a plan participant, at a time when the interest rates charged by financial institutions in the community (not subject to the usury limit) for similar loans are higher than the usury limit. Under these circumstances, the loan would not bear a reasonable rate of interest because the loan does not provide P with a return commensurate with the interest rates charged by persons in the business of lending money under similar circumstances. In addition, participant loans that are artificially limited to the maximum usury ceiling then prevailing call into question the status of such loans under sections 403(c) and 404(a) where higher yielding comparable investment opportunities are available to the plan.

(f) *Adequate security.* (1) A loan will be considered to be adequately secured if the security posted for such loan is something in addition to and supporting a promise to pay, which is so pledged to the plan that it may be sold, foreclosed upon, or otherwise disposed of upon default of repayment of the loan, the value and liquidity of which security is such that it may reasonably be anticipated that loss of principal or interest will not result from the loan. The adequacy of such security will be determined in light of the type and amount of security which would be required in the case of an otherwise identical transaction in a normal commercial setting between unrelated parties on arm's-length terms. A participant's vested accrued benefit under a plan may be used as security for a participant loan to the extent of the plan's ability to satisfy the participant's out-

standing obligation in the event of default.

(2) For purposes of this paragraph,

(i) No more than 50% of the present value of a participant's vested accrued benefit may be considered by a plan as security for the outstanding balance of all plan loans made to that participant;

(ii) A plan will be in compliance with paragraph (f)(2)(i) of this section if, with respect to any participant, it meets the provisions of paragraph (f)(2)(i) of this section immediately after the origination of each participant loan secured in whole or in part by that participant's vested accrued benefit; and

(iii) Any loan secured in whole or in part by a portion of a participant's vested accrued benefit must also meet the requirements of paragraph (f)(1) of this section.

(g) *Effective date.* This section is effective for all participant loans granted or renewed after October 18, 1989, except with respect to paragraph (d)(2) of this section relating to specific plan provisions. Paragraph (d)(2) of this section is effective for participant loans granted or renewed on or after the last day of the first plan year beginning on or after January 1, 1989.

(Approved by the Office of Management and Budget under control number 1210-0076)

[54 FR 30528, July 20, 1989]

§ 2550.408b-2 General statutory exemption for services or office space.

(a) *In general.* Section 408(b)(2) of the Employee Retirement Income Security Act of 1974 (the Act) exempts from the prohibitions of section 406(a) of the Act payment by a plan to a party in interest, including a fiduciary, for office space or any service (or a combination of services) if:

(1) Such office space or service is necessary for the establishment or operation of the plan;

(2) Such office space or service is furnished under a contract or arrangement which is reasonable; and

(3) No more than reasonable compensation is paid for such office space or service.

However, section 408(b)(2) does not contain an exemption from acts described in section 406(b)(1) of the Act (relating

to fiduciaries dealing with the assets of plans in their own interest or for their own account), section 406(b)(2) of the Act (relating to fiduciaries in their individual or in any other capacity acting in any transaction involving the plan on behalf of a party (or representing a party) whose interests are adverse to the interests of the plan or the interests of its participants or beneficiaries) or section 406(b)(3) of the Act (relating to fiduciaries receiving consideration for their own personal account from any party dealing with a plan in connection with a transaction involving the assets of the plan). Such acts are separate transactions not described in section 408(b)(2). See § 2550.408b-2 (e) and (f) for guidance as to whether transactions relating to the furnishing of office space or services by fiduciaries to plans involve acts described in section 406(b)(1) of the Act. Section 408(b)(2) of the Act does not contain an exemption from other provisions of the Act, such as section 404, or other provisions of law which may impose requirements or restrictions relating to the transactions which are exempt under section 408(b)(2). See, for example, section 401 of the Internal Revenue Code of 1954. The provisions of section 408(b)(2) of the Act are further limited by section 408(d) of the Act (relating to transactions with owner-employees and related persons).

(b) *Necessary service.* A service is necessary for the establishment or operation of a plan within the meaning of section 408(b)(2) of the Act and § 2550.408b-2(a)(1) if the service is appropriate and helpful to the plan obtaining the service in carrying out the purposes for which the plan is established or maintained. A person providing such a service to a plan (or a person who is a party in interest solely by reason of a relationship to such a service provider described in section 3(14)(F), (G), (H), or (I) of the Act) may furnish goods which are necessary for the establishment or operation of the plan in the course of, and incidental to, the furnishing of such service to the plan.

(c) *Reasonable contract or arrangement.* No contract or arrangement is reasonable within the meaning of section 408(b)(2) of the Act and § 2550.408b-2(a)(2) if it does not permit termination

by the plan without penalty to the plan on reasonably short notice under the circumstances to prevent the plan from becoming locked into an arrangement that has become disadvantageous. A long-term lease which may be terminated prior to its expiration (without penalty to the plan) on reasonably short notice under the circumstances is not generally an unreasonable arrangement merely because of its long term. A provision in a contract or other arrangement which reasonably compensates the service provider or lessor for loss upon early termination of the contract, arrangement or lease is not a penalty. For example, a minimal fee in a service contract which is charged to allow recoupment of reasonable start-up costs is not a penalty. Similarly, a provision in a lease for a termination fee that covers reasonably foreseeable expenses related to the vacancy and reletting of the office space upon early termination of the lease is not a penalty. Such a provision does not reasonably compensate for loss if it provides for payment in excess of actual loss or if it fails to require mitigation of damages.

(d) *Reasonable compensation.* Section 408(b)(2) of the Act and § 2550.408b-2(a)(3) permit a plan to pay a party in interest reasonable compensation for the provision of office space or services described in section 408(b)(2). Section 2550.408c-2 of these regulations contains provisions relating to what constitutes reasonable compensation for the provision of services.

(e) *Transactions with fiduciaries—(1) In general.* If the furnishing of office space or a service involves an act described in section 406(b) of the Act (relating to acts involving conflicts of interest by fiduciaries), such an act constitutes a separate transaction which is not exempt under section 408(b)(2) of the Act. The prohibitions of section 406(b) supplement the other prohibitions of section 406(a) of the Act by imposing on parties in interest who are fiduciaries a duty of undivided loyalty to the plans for which they act. These prohibitions are imposed upon fiduciaries to deter them from exercising the authority, control, or responsibility which makes such persons fiduciaries when they have interests which may conflict with

the interests of the plans for which they act. In such cases, the fiduciaries have interests in the transactions which may affect the exercise of their best judgment as fiduciaries. Thus, a fiduciary may not use the authority, control, or responsibility which makes such person a fiduciary to cause a plan to pay an additional fee to such fiduciary (or to a person in which such fiduciary has an interest which may affect the exercise of such fiduciary's best judgment as a fiduciary) to provide a service. Nor may a fiduciary use such authority, control, or responsibility to cause a plan to enter into a transaction involving plan assets whereby such fiduciary (or a person in which such fiduciary has an interest which may affect the exercise of such fiduciary's best judgment as a fiduciary) will receive consideration from a third party in connection with such transaction. A person in which a fiduciary has an interest which may affect the exercise of such fiduciary's best judgment as a fiduciary includes, for example, a person who is a party in interest by reason of a relationship to such fiduciary described in section 3(14)(E), (F), (G), (H), or (I).

(2) *Transactions not described in section 406(b)(1).* A fiduciary does not engage in an act described in section 406(b)(1) of the Act if the fiduciary does not use any of the authority, control or responsibility which makes such person a fiduciary to cause a plan to pay additional fees for a service furnished by such fiduciary or to pay a fee for a service furnished by a person in which such fiduciary has an interest which may affect the exercise of such fiduciary's best judgment as a fiduciary. This may occur, for example, when one fiduciary is retained on behalf of a plan by a second fiduciary to provide a service for an additional fee. However, because the authority, control or responsibility which makes a person a fiduciary may be exercised "in effect" as well as in form, mere approval of the transaction by a second fiduciary does not mean that the first fiduciary has not used any of the authority, control or responsibility which makes such person a fiduciary to cause the plan to pay the first fiduciary an additional fee

for a service. See paragraph (f) of this section.

(3) *Services without compensation.* If a fiduciary provides services to a plan without the receipt of compensation or other consideration (other than reimbursement of direct expenses properly and actually incurred in the performance of such services within the meaning of § 2550.408c-2(b)(3)), the provision of such services does not, in and of itself, constitute an act described in section 406(b) of the Act. The allowance of a deduction to an employer under section 162 or 212 of the Code for the expense incurred in furnishing office space or services to a plan established or maintained by such employer does not constitute compensation or other consideration.

(f) *Examples.* The provisions of § 2550.408b-2(e) may be illustrated by the following examples.

Example 1. E, an employer whose employees are covered by plan P, is a fiduciary of P. I is a professional investment adviser in which E has no interest which may affect the exercise of E's best judgment as a fiduciary. E causes P to retain I to provide certain kinds of investment advisory services of a type which causes I to be a fiduciary of P under section 3(21)(A)(ii) of the Act. thereafter, I proposes to perform for additional fees portfolio evaluation services in addition to the services currently provided. The provision of such services is arranged by I and approved on behalf of the plan by E. I has not engaged in an act described in section 406(b)(1) of the Act, because I did not use any of the authority, control or responsibility which makes I a fiduciary (the provision of investment advisory services) to cause the plan to pay I additional fees for the provision of the portfolio evaluation services. E has not engaged in an act which is described in section 406(b)(1). E, as the fiduciary who has the responsibility to be prudent in his selection and retention of I and the other investment advisers of the plan, has an interest in the purchase by the plan of portfolio evaluation services. However, such an interest is not an interest which may affect the exercise of E's best judgment as a fiduciary.

Example 2. D, a trustee of plan P with discretion over the management and disposition of plan assets, relies on the advice of C, a consultant to P, as to the investment of plan assets, thereby making C a fiduciary of the plan. On January 1, 1978, C recommends to D that the plan purchase an insurance policy from U, an insurance company which is not

a party in interest with respect to P. C thoroughly explains the reasons for the recommendation and makes a full disclosure concerning the fact that C will receive a commission from U upon the purchase of the policy of P. D considers the recommendation and approves the purchase of the policy by P. C receives a commission. Under such circumstances, C has engaged in an act described in section 406(b)(1) of the Act (as well as sections 406(b)(2) and (3) of the Act) because C is in fact exercising the authority, control or responsibility which makes C a fiduciary to cause the plan to purchase the policy. However, the transaction is exempt from the prohibited transaction provisions of section 406 of the Act, if the requirements of Prohibited Transaction Exemption 77-9 are met.

Example 3. Assume the same facts as in Example (2) except that the nature of C's relationship with the plan is not such that C is a fiduciary of P. The purchase of the insurance policy does not involve an act described in section 406(b)(1) of the Act (or sections 406(b)(2) or (3) of the Act) because such sections only apply to acts by fiduciaries.

Example 4. E, an employer whose employees are covered by plan P, is a fiduciary with respect to P. A, who is not a party in interest with respect to P, persuades E that the plan needs the services of a professional investment adviser and that A should be hired to provide the investment advice. Accordingly, E causes P to hire A to provide investment advice of the type which makes A a fiduciary under § 2510.3-21(c)(1)(ii)(B). Prior to the expiration of A's first contract with P, A persuades E to cause P to renew A's contract with P to provide the same services for additional fees in view of the increased costs in providing such services. During the period of A's second contract, A provides additional investment advice services for which no additional charge is made. Prior to the expiration of A's second contract, A persuades E to cause P to renew his contract for additional fees in view of the additional services A is providing. A has not engaged in an act described in section 406(b)(1) of the Act, because A has not used any of the authority, control or responsibility which makes A a fiduciary (the provision of investment advice) to cause the plan to pay additional fees for A's services.

Example 5. F, a trustee of plan P with discretion over the management and disposition of plan assets, retains C to provide administrative services to P of the type which makes C a fiduciary under section 3(21)(A)(iii). Thereafter, C retains F to provide for additional fees actuarial and various kinds of administrative services in addition to the services F is currently providing to P. Both F and C have engaged in an act described in section 406(b)(1) of the Act. F, regardless of any intent which he may have

had at the time he retained C, has engaged in such an act because F has, in effect, exercised the authority, control or responsibility which makes F a fiduciary to cause the plan to pay F additional fees for the services. C, whose continued employment by P depends on F, has also engaged in such an act, because C has an interest in the transaction which might affect the exercise of C's best judgment as a fiduciary. As a result, C has dealt with plan assets in his own interest under section 406(b)(1).

Example 6. F, a fiduciary of plan P with discretionary authority respecting the management of P, retains S, the son of F, to provide for a fee various kinds of administrative services necessary for the operation of the plan. F has engaged in an act described in section 406(b)(1) of the Act because S is a person in whom F has an interest which may affect the exercise of F's best judgment as a fiduciary. Such act is not exempt under section 408(b)(2) of the Act irrespective of whether the provision of the services by S is exempt.

Example 7. T, one of the trustees of plan P, is president of bank B. The bank proposes to provide administrative services to P for a fee. T physically absents himself from all consideration of B's proposal and does not otherwise exercise any of the authority, control or responsibility which makes T a fiduciary to cause the plan to retain B. The other trustees decide to retain B. T has not engaged in an act described in section 406(b)(1) of the Act. Further, the other trustees have not engaged in an act described in section 406(b)(1) merely because T is on the board of trustees of P. This fact alone would not make them have an interest in the transaction which might affect the exercise of their best judgment as fiduciaries.

[42 FR 32390, June 24, 1977]

EFFECTIVE DATE NOTE: At 75 FR 41635, July 16, 2010, § 2550.408b-2(c) was revised, effective July 16, 2011. For the convenience of the user, the revised text is set forth as follows:

§ 2550.408b-2 General statutory exemption for services or office space.

* * * * *

(c) *Reasonable contract or arrangement—*

(1) *Pension plan disclosure.*

(i) *General.* No contract or arrangement for services between a covered plan and a covered service provider, nor any extension or renewal, is reasonable within the meaning of section 408(b)(2) of the Act and paragraph (a)(2) of this section unless the requirements of this paragraph (c)(1) are satisfied. The requirements of this paragraph (c)(1) are independent of fiduciary obligations under section 404 of the Act.

(ii) *Covered plan.* For purposes of this paragraph (c)(1), a “covered plan” is an “employee pension benefit plan” or a “pension plan” within the meaning of section 3(2)(A) (and not described in section 4(b)) of the Act, except that the term “covered plan” shall not include a “simplified employee pension” described in section 408(k) of the Internal Revenue Code of 1986 (the Code), a “simple retirement account” described in section 408(p) of the Code, an individual retirement account described in section 408(a) of the Code, or an individual retirement annuity described in section 408(b) of the Code.

(iii) *Covered service provider.* For purposes of this paragraph (c)(1), a “covered service provider” is a service provider that enters into a contract or arrangement with the covered plan and reasonably expects \$1,000 or more in compensation, direct or indirect, to be received in connection with providing one or more of the services described in paragraphs (c)(1)(iii)(A), (B), or (C) of this section pursuant to the contract or arrangement, regardless of whether such services will be performed, or such compensation received, by the covered service provider, an affiliate, or a subcontractor.

(A) *Services as a fiduciary or registered investment adviser.*

(1) Services provided directly to the covered plan as a fiduciary (unless otherwise specified, a “fiduciary” in this paragraph (c)(1) is a fiduciary within the meaning of section 3(21) of the Act);

(2) Services provided as a fiduciary to an investment contract, product, or entity that holds plan assets (as determined pursuant to sections 3(42) and 401 of the Act and 29 CFR 2510.3-101) and in which the covered plan has a direct equity investment (a direct equity investment does not include investments made by the investment contract, product, or entity in which the covered plan invests); or

(3) Services provided directly to the covered plan as an investment adviser registered under either the Investment Advisers Act of 1940 or any State law.

(B) *Certain recordkeeping or brokerage services.* Recordkeeping services or brokerage services provided to a covered plan that is an individual account plan, as defined in section 3(34) of the Act, and that permits participants or beneficiaries to direct the investment of their accounts, if one or more designated investment alternatives will be made available (*e.g.*, through a platform or similar mechanism) in connection with such recordkeeping services or brokerage services.

(C) *Other services for indirect compensation.* Accounting, auditing, actuarial, appraisal, banking, consulting (*i.e.*, consulting related to the development or implementation of investment policies or objectives, or the selection or monitoring of service providers or plan investments), custodial, insurance, in-

vestment advisory (for plan or participants), legal, recordkeeping, securities or other investment brokerage, third party administration, or valuation services provided to the covered plan, for which the covered service provider, an affiliate, or a subcontractor reasonably expects to receive indirect compensation (as defined in paragraph (c)(1)(viii)(B)(2) of this section) or compensation described in paragraph (c)(1)(iv)(C)(3) of this section).

(D) *Limitations.* Notwithstanding paragraphs (c)(1)(iii)(A), (B), or (C) of this section, no person or entity is a “covered service provider” solely by providing services—

(1) As an affiliate or a subcontractor that is performing one or more of the services described in paragraphs (c)(1)(iii)(A), (B), or (C) of this section under the contract or arrangement with the covered plan; or

(2) To an investment contract, product, or entity in which the covered plan invests, regardless of whether or not the investment contract, product, or entity holds assets of the covered plan, other than services as a fiduciary described in paragraph (c)(1)(iii)(A)(2) of this section.

(iv) *Initial disclosure requirements.* The covered service provider must disclose the following information to a responsible plan fiduciary, in writing—

(A) *Services.* A description of the services to be provided to the covered plan pursuant to the contract or arrangement (but not including non-fiduciary services described in paragraph (c)(1)(iii)(D)(2) of this section).

(B) *Status.* If applicable, a statement that the covered service provider, an affiliate, or a subcontractor will provide, or reasonably expects to provide, services pursuant to the contract or arrangement directly to the covered plan (or to an investment contract, product or entity that holds plan assets and in which the covered plan has a direct equity investment) as a fiduciary; and, if applicable, a statement that the covered service provider, an affiliate, or a subcontractor will provide, or reasonably expects to provide, services pursuant to the contract or arrangement directly to the covered plan as an investment adviser registered under either the Investment Advisers Act of 1940 or any State law.

(C) *Compensation.*

(1) *Direct compensation.* A description of all direct compensation (as defined in paragraph (c)(1)(viii)(B)(1) of this section), either in the aggregate or by service, that the covered service provider, an affiliate, or a subcontractor reasonably expects to receive in connection with the services described pursuant to paragraph (c)(1)(iv)(A) of this section.

(2) *Indirect compensation.* A description of all indirect compensation (as defined in paragraph (c)(1)(viii)(B)(2) of this section) that the covered service provider, an affiliate, or a subcontractor reasonably expects

to receive in connection with the services described pursuant to paragraph (c)(1)(iv)(A) of this section; including identification of the services for which the indirect compensation will be received and identification of the payer of the indirect compensation.

(3) *Compensation paid among related parties.* A description of any compensation that will be paid among the covered service provider, an affiliate, or a subcontractor, in connection with the services described pursuant to paragraph (c)(1)(iv)(A) of this section if it is set on a transaction basis (e.g., commissions, soft dollars, finder's fees or other similar incentive compensation based on business placed or retained) or is charged directly against the covered plan's investment and reflected in the net value of the investment (e.g., Rule 12b-1 fees); including identification of the services for which such compensation will be paid and identification of the payers and recipients of such compensation (including the status of a payer or recipient as an affiliate or a subcontractor). Compensation must be disclosed pursuant to this paragraph (c)(1)(iv)(C)(3) regardless of whether such compensation also is disclosed pursuant to paragraph (c)(1)(iv)(C)(1) or (2), (F) or (G) of this section. This paragraph (c)(1)(iv)(C)(3) shall not apply to compensation received by an employee from his or her employer on account of work performed by the employee.

(4) *Compensation for termination of contract or arrangement.* A description of any compensation that the covered service provider, an affiliate, or a subcontractor reasonably expects to receive in connection with termination of the contract or arrangement, and how any prepaid amounts will be calculated and refunded upon such termination.

(D) *Recordkeeping services.* Without regard to the disclosure of compensation pursuant to paragraph (c)(1)(iv)(C), (F), or (G) of this section, if recordkeeping services will be provided to the covered plan—

(1) A description of all direct and indirect compensation that the covered service provider, an affiliate, or a subcontractor reasonably expects to receive in connection with such recordkeeping services; and

(2) If the covered service provider reasonably expects recordkeeping services to be provided, in whole or in part, without explicit compensation for such recordkeeping services, or when compensation for recordkeeping services is offset or rebated based on other compensation received by the covered service provider, an affiliate, or a subcontractor, a reasonable and good faith estimate of the cost to the covered plan of such recordkeeping services, including an explanation of the methodology and assumptions used to prepare the estimate and a detailed explanation of the recordkeeping services that will be provided to the covered plan. The estimate shall take into account, as ap-

plicable, the rates that the covered service provider, an affiliate, or a subcontractor would charge to, or be paid by, third parties, or the prevailing market rates charged, for similar recordkeeping services for a similar plan with a similar number of covered participants and beneficiaries.

(E) *Manner of receipt.* A description of the manner in which the compensation described in paragraph (c)(1)(iv)(C) and (D) of this section will be received, such as whether the covered plan will be billed or the compensation will be deducted directly from the covered plan's account(s) or investments.

(F) *Investment disclosure—fiduciary services.* In the case of a covered service provider described in paragraph (c)(1)(iii)(A)(2) of this section, the following additional information with respect to each investment contract, product, or entity that holds plan assets and in which the covered plan has a direct equity investment, and for which fiduciary services will be provided pursuant to the contract or arrangement with the covered plan, unless such information is disclosed to the responsible plan fiduciary by a covered service provider providing recordkeeping services or brokerage services as described in paragraph (c)(1)(iii)(B) of this section—

(1) A description of any compensation that will be charged directly against the amount invested in connection with the acquisition, sale, transfer of, or withdrawal from the investment contract, product, or entity (e.g., sales loads, sales charges, deferred sales charges, redemption fees, surrender charges, exchange fees, account fees, and purchase fees);

(2) A description of the annual operating expenses (e.g., expense ratio) if the return is not fixed; and

(3) A description of any ongoing expenses in addition to annual operating expenses (e.g., wrap fees, mortality and expense fees).

(G) *Investment disclosure—recordkeeping and brokerage services.*

(1) In the case of a covered service provider described in paragraph (c)(1)(iii)(B) of this section, the additional information described in paragraph (c)(1)(iv)(F)(1) through (3) of this section with respect to each designated investment alternative for which recordkeeping services or brokerage services as described in paragraph (c)(1)(iii)(B) of this section will be provided pursuant to the contract or arrangement with the covered plan.

(2) A covered service provider may comply with this paragraph (c)(1)(iv)(G) by providing current disclosure materials of the issuer of the designated investment alternative that include the information described in such paragraph, provided that such issuer is not an affiliate, the disclosure materials are regulated by a State or federal agency, and the covered service provider does not know that the materials are incomplete or inaccurate.

(v) *Timing of initial disclosure requirements; changes.*

(A) A covered service provider must disclose the information required by paragraph (c)(1)(iv) of this section to the responsible plan fiduciary reasonably in advance of the date the contract or arrangement is entered into, and extended or renewed, except that—

(1) When an investment contract, product, or entity is determined not to hold plan assets upon the covered plan's direct equity investment, but subsequently is determined to hold plan assets while the covered plan's investment continues, the information required by paragraph (c)(1)(iv) of this section must be disclosed as soon as practicable, but not later than 30 days from the date on which the covered service provider knows that such investment contract, product, or entity holds plan assets; and

(2) The information described in paragraph (c)(1)(iv)(G) of this section relating to any investment alternative that is not designated at the time the contract or arrangement is entered into must be disclosed as soon as practicable, but not later than the date the investment alternative is designated by the responsible plan fiduciary.

(B) A covered service provider must disclose a change to the information required by paragraph (c)(1)(iv) of this section as soon as practicable, but not later than 60 days from the date on which the covered service provider is informed of such change, unless such disclosure is precluded due to extraordinary circumstances beyond the covered service provider's control, in which case the information must be disclosed as soon as practicable.

(vi) *Reporting and disclosure information; timing.*

(A) Upon request of the responsible plan fiduciary or covered plan administrator, the covered service provider must furnish any other information relating to the compensation received in connection with the contract or arrangement that is required for the covered plan to comply with the reporting and disclosure requirements of Title I of the Act and the regulations, forms and schedules issued thereunder.

(B) The covered service provider must disclose the information required by paragraph (c)(1)(vi)(A) of this section not later than 30 days following receipt of a written request from the responsible plan fiduciary or covered plan administrator, unless such disclosure is precluded due to extraordinary circumstances beyond the covered service provider's control, in which case the information must be disclosed as soon as practicable.

(vii) *Disclosure errors.* No contract or arrangement will fail to be reasonable under this paragraph (c)(1) solely because the covered service provider, acting in good faith and with reasonable diligence, makes an error or omission in disclosing the informa-

tion required pursuant to paragraph (c)(1)(iv) or (vi) of this section, provided that the covered service provider discloses the correct information to the responsible plan fiduciary as soon as practicable, but not later than 30 days from the date on which the covered service provider knows of such error or omission.

(viii) *Definitions.* For purposes of paragraph (c)(1) of this section:

(A) *Affiliate.* A person's or entity's "affiliate" directly or indirectly (through one or more intermediaries) controls, is controlled by, or is under common control with such person or entity; or is an officer, director, or employee of, or partner in, such person or entity. Unless otherwise specified, an "affiliate" in this paragraph (c)(1) refers to an affiliate of the covered service provider.

(B) *Compensation.* Compensation is anything of monetary value (for example, money, gifts, awards, and trips), but does not include non-monetary compensation valued at \$250 or less, in the aggregate, during the term of the contract or arrangement.

(1) "*Direct*" compensation is compensation received directly from the covered plan.

(2) "*Indirect*" compensation is compensation received from any source other than the covered plan, the plan sponsor, the covered service provider, an affiliate, or a subcontractor (if the subcontractor receives such compensation in connection with services performed under the subcontractor's contract or arrangement described in paragraph (c)(1)(viii)(F) of this section).

(3) A description or an estimate of compensation may be expressed as a monetary amount, formula, percentage of the covered plan's assets, or a per capita charge for each participant or beneficiary or, if the compensation cannot reasonably be expressed in such terms, by any other reasonable method. Any description or estimate must contain sufficient information to permit evaluation of the reasonableness of the compensation.

(C) *Designated investment alternative.* A "designated investment alternative" is any investment alternative designated by a fiduciary into which participants and beneficiaries may direct the investment of assets held in, or contributed to, their individual accounts. The term "designated investment alternative" shall not include brokerage windows, self-directed brokerage accounts, or similar plan arrangements that enable participants and beneficiaries to select investments beyond those specifically designated.

(D) *Recordkeeping services.* "Recordkeeping services" include services related to plan administration and monitoring of plan and participant and beneficiary transactions (e.g., enrollment, payroll deductions and contributions, offering designated investment alternatives and other covered plan investments, loans, withdrawals and distributions); and

the maintenance of covered plan and participant and beneficiary accounts, records, and statements.

(E) *Responsible plan fiduciary.* A “responsible plan fiduciary” is a fiduciary with authority to cause the covered plan to enter into, or extend or renew, the contract or arrangement.

(F) *Subcontractor.* A “subcontractor” is any person or entity (or an affiliate of such person or entity) that is not an affiliate of the covered service provider and that, pursuant to a contract or arrangement with the covered service provider or an affiliate, reasonably expects to receive \$1,000 or more in compensation for performing one or more services described pursuant to paragraph (c)(1)(iii)(A) through (C) of this section provided for by the contract or arrangement with the covered plan.

(ix) *Exemption for responsible plan fiduciary.* Pursuant to section 408(a) of the Act, the restrictions of section 406(a)(1)(C) and (D) of the Act shall not apply to a responsible plan fiduciary, notwithstanding any failure by a covered service provider to disclose information required by paragraph (c)(1)(iv) or (vi) of this section, if the following conditions are met:

(A) The responsible plan fiduciary did not know that the covered service provider failed or would fail to make required disclosures and reasonably believed that the covered service provider disclosed the information required by paragraph (c)(1)(iv) or (vi) of this section;

(B) The responsible plan fiduciary, upon discovering that the covered service provider failed to disclose the required information, requests in writing that the covered service provider furnish such information;

(C) If the covered service provider fails to comply with such written request within 90 days of the request, then the responsible plan fiduciary notifies the Department of Labor of the covered service provider's failure, in accordance with paragraph (c)(1)(ix)(E) of this section;

(D) The notice shall contain the following information—

- (1) The name of the covered plan;
- (2) The plan number used for the covered plan's Annual Report;
- (3) The plan sponsor's name, address, and EIN;
- (4) The name, address, and telephone number of the responsible plan fiduciary;
- (5) The name, address, phone number, and, if known, EIN of the covered service provider;
- (6) A description of the services provided to the covered plan;
- (7) A description of the information that the covered service provider failed to disclose;

(8) The date on which such information was requested in writing from the covered service provider; and

(9) A statement as to whether the covered service provider continues to provide services to the plan;

(E) The notice shall be filed with the Department not later than 30 days following the earlier of—

(1) The covered service provider's refusal to furnish the information requested by the written request described in paragraph (c)(1)(ix)(B) of this section; or

(2) 90 days after the written request referred to in paragraph (c)(1)(ix)(B) of this section is made;

(F) The notice required by paragraph (c)(1)(ix)(C) of this section shall be sent to the following address: U.S. Department of Labor, Employee Benefits Security Administration, Office of Enforcement, 200 Constitution Ave., NW., Suite 600, Washington, DC 20210; or may be sent electronically to *OE-DelinquentSPnotice@dol.gov*; and

(G) The responsible plan fiduciary, following discovery of a failure to disclose required information, shall determine whether to terminate or continue the contract or arrangement. In making such a determination, the responsible plan fiduciary shall evaluate the nature of the failure, the availability, qualifications, and cost of replacement service providers, and the covered service provider's response to notification of the failure.

(x) *Preemption of State law.* Nothing in this section shall be construed to supersede any provision of State law that governs disclosures by parties that provide the services described in this section, except to the extent that such law prevents the application of a requirement of this section.

(xi) *Internal Revenue Code.* Section 4975(d)(2) of the Code contains provisions parallel to section 408(b)(2) of the Act. Effective December 31, 1978, section 102 of the Reorganization Plan No. 4 of 1978, 5 U.S.C. App. 214 (2000 ed.), transferred the authority of the Secretary of the Treasury to promulgate regulations of the type published herein to the Secretary of Labor. All references herein to section 408(b)(2) of the Act and the regulations thereunder should be read to include reference to the parallel provisions of section 4975(d)(2) of the Code and regulations thereunder at 26 CFR 54.4975-6.

(xii) *Effective date.* Paragraph (c) of this section shall be effective on July 16, 2011. Paragraph (c)(1) of this section shall apply to contracts or arrangements between covered plans and covered service providers as of the effective date, without regard to whether the contract or arrangement was entered into prior to such date; for contracts or arrangement entered into prior to the effective date, the information required to be disclosed pursuant to paragraph (c)(1)(iv) of this section

must be furnished no later than the effective date.

(2) *Welfare plan disclosure.* [Reserved]

(3) *Termination of contract or arrangement.* No contract or arrangement is reasonable within the meaning of section 408(b)(2) of the Act and paragraph (a)(2) of this section if it does not permit termination by the plan without penalty to the plan on reasonably short notice under the circumstances to prevent the plan from becoming locked into an arrangement that has become disadvantageous. A long-term lease which may be terminated prior to its expiration (without penalty to the plan) on reasonably short notice under the circumstances is not generally an unreasonable arrangement merely because of its long term. A provision in a contract or other arrangement which reasonably compensates the service provider or lessor for loss upon early termination of the contract, arrangement, or lease is not a penalty. For example, a minimal fee in a service contract which is charged to allow recoupment of reasonable start-up costs is not a penalty. Similarly, a provision in a lease for a termination fee that covers reasonably foreseeable expenses related to the vacancy and reletting of the office space upon early termination of the lease is not a penalty. Such a provision does not reasonably compensate for loss if it provides for payment in excess of actual loss or if it fails to require mitigation of damages.

* * * * *

§ 2550.408b-3 Loans to Employee Stock Ownership Plans.

(a) *Definitions.* When used in this section, the terms listed below have the following meanings:

(1) *ESOP.* The term *ESOP* refers to an employee stock ownership plan that meets the requirements of section 407(d)(6) of the Employee Retirement Income Security Act of 1974 (the Act) and 29 CFR 2550.407d-6. It is not synonymous with “stock bonus plan.” A stock bonus plan must, however, be an ESOP to engage in an exempt loan. The qualification of an ESOP under section 401 (a) of the Internal Revenue Code (the Code) and 26 CFR 54.4975-11 will not be adversely affected merely because it engages in a non-exempt loan.

(2) *Loan.* The term *loan* refers to a loan made to an ESOP by a party in interest or a loan to an ESOP which is guaranteed by a party in interest. It includes a direct loan of cash, a purchase-money transaction, and an assumption of the obligation of an ESOP.

“Guarantee” includes an unsecured guarantee and the use of assets of a party in interest as collateral for a loan, even though the use of assets may not be a guarantee under applicable state law. An amendment of a loan in order to qualify as an exempt loan is not a refinancing of the loan or the making of another loan.

(3) *Exempt loan.* The term *exempt loan* refers to a loan that satisfies the provisions of this section. A “non-exempt loan” is one that fails to satisfy such provisions.

(4) *Publicly traded.* The term *publicly traded* refers to a security that is listed on a national securities exchange registered under section 6 of the Securities Exchange Act of 1934 (15 U.S.C. 78f) or that is quoted on a system sponsored by a national securities association registered under section 15A(b) of the Securities Exchange Act (15 U.S.C. 78o).

(5) *Qualifying employer security.* The term *qualifying employer security* refers to a security described in 29 CFR 2550.407d-5.

(b) *Statutory exemption*—(1) *Scope.* Section 408(b)(3) of the Act provides an exemption from the prohibited transaction provisions of sections 406(a) and 406(b)(1) of the Act (relating to fiduciaries dealing with the assets of plans in their own interest or for their own account) and 406(b)(2) of the Act (relating to fiduciaries in their individual or in any other capacity acting in any transaction involving the plan on behalf of a party (or representing a party) whose interests are adverse to the interests of the plan or the interests of its participants or beneficiaries). Section 408(b)(3) does not provide an exemption from the prohibitions of section 406(b)(3) of the Act (relating to fiduciaries receiving consideration for their own personal account from any party dealing with a plan in connection with a transaction involving the income or assets of the plan).

(2) *Special scrutiny of transaction.* The exemption under section 408(b)(3) includes within its scope certain transaction in which the potential for self-dealing by fiduciaries exists and in which the interests of fiduciaries may conflict with the interests of participants. To guard against these potential